Canadian Pacific News

Release: Immediate, May 1, 1974

Text of Address

by Ian D. Sinclair, Chairman and Chief Executive Officer,

Canadian Pacific

to

the ninety-third annual general meeting

of shareholders at Montreal, Quebec

May 1, 1974

On behalf of the Board of Directors of Canadian Pacific Limited I extend a warm welcome to all of you here today at this 93rd annual general meeting of shareholders of the Company.

One of the first items of business at our meetings is the adoption of the annual report of the directors for the previous year. I shall request a motion to that effect, but before doing so there are a number of observations I would like to make.

It is always agreeable to have favorable expectations fulfilled. That is the fortunate position we are in with respect to 1973 earnings. A year ago I said that we expected 1973 net income to be well above $100 million. As it turned out, earnings amounted to $126 million, an increase of $30 million over those of 1972.

The new form of presentation of the statement of income makes it easy to see that almost all the increase was in the earnings of Canadian Pacific Investments Limited and in the Company's equity in the income of its unconsolidated subsidiary, Soo Line Railroad Company. As the annual report

MORE

points out, the results of the Canadian-based transportation group were depressed by strikes and by cost increases which could not be recovered from price increases.

The Company's results for the first quarter of 1974 are being released to the press today. They will be mailed to shareholders at the same time as the Report of Proceedings of today's meeting. Net income for the quarter amounted to $37.8 million, an increase of $9.6 million over the first quarter of 1973. Per Ordinary share, earnings amounted to 52¢, compared with 38¢ per share in the same quarter of 1973. Again, as in 1973, the improvement was mainly attributable to higher earnings of Canadian Pacific Investments Limited. However, a welcome new factor was the improvement in the results of CP Ships.

CPI had a very strong first quarter. All segments of its operations, with the single exception of forest products, did better than in the first three months of 1973. Mining and oil and gas were particularly strong. Firm markets and better prices for fertilizers and for lead, zinc and silver and increased production and better prices for oil and gas were the basis for the higher net of those two operating sectors.

MORE

CP Steamships Limited earned a profit of $882,000 in the first three months in contrast to the loss of $940,000 sustained in the first quarter of 1973. The principal contributing factor to this turnaround was an increase in container rates. Further rate increases are expected later this year. Also important was the fact that the container vessels have been operating at almost full capacity. Net income of CP (Bermuda) was also up, reflecting mainly the operation of two more vessels than in the first three months of 1973.

On the other hand -- CP Rail, CP Trucks and CP Air -- together with CP Telecommunications have not fared as well. Net income of CP Rail, for example, was down $4.1 million, or nearly 50 per cent lower, and CP Air was down $1.8 million. Revenues were uniformly up, in some cases impressively so, as the Canadian economy has maintained a high rate of growth. However, cost escalations have overtaken even these record levels of revenues. Higher wage rates and benefits and sharp increases in fuel prices were chiefly responsible for the rise in expenses, although other operating costs have climbed rapidly as well.

MORE

In evaluating the prospects for the balance of the year, it now looks as if Canadian Pacific Investments Limited will, as it did in 1973, provide a major part of any increase in earnings. Continuing high demands for resource products and a buoyant Canadian economy support a cautious optimism with regard to CPI. The caution is dictated by uncertainties concerning the impact of new mining and forestry taxes in British Columbia and Ontario. Making some allowance for that, CPI expects its 1974 income to be higher than in 1973, though the rate of increase will not be as great as it was in that year.

CP Ships should have a highly favorable year, with the container ship operations continuing to improve and with additional new ships augmenting the CP (Bermuda) fleet over the coming months.

For CP Rail, CP Trucks, and CP Telecommunications the crucial question is rates. CP Telecommunications, jointly with Canadian National, filed a rate increase application last November, and a further application was filed early in April in an effort to offset, in part, the effects of higher wages. No date for a hearing of these applications

MORE

has yet been announced by the Canadian Transport Commission. CP Rail is still operating under the freight rate freeze imposed by the government. A request made earlier in the year jointly with the Canadian National for government approval of a surcharge on freight prices to match fuel price increases is in abeyance. Unless the authorities move to permit revenues to keep up to the rise in costs, both rail and telecommunication earnings cannot help but fall precipitously below their 1973 levels. CP Trucks, also squeezed by rapidly rising costs, can make some savings in expenses by trimming unprofitable services.

For CP Air it is now certain that 1974 will prove to be a much less satisfactory year than could reasonably have been anticipated. In the face of the problems of rising costs and fuel availability, it was expected that normal operations would be carried on, but at a somewhat reduced profit. Now, however, the inability -- or the unwillingness -- of the government of Canada to protect the national economy, and particularly the commercial aviation industry, from the disastrous effects of illegal work stoppages has seriously jeopardized the possibility of a profitable operation in 1974.

MORE

In summary, the prospects for CPI and CP Ships are good. The outlook for transportation operations other than ships is clouded, mainly by the effects of government action, or inaction. Overall, net income of Canadian Pacific Limited should increase in the order of 10 per cent.

The transportation group is the subject of our greatest immediate concern, and this meeting of the owners of Canadian Pacific gives me a welcome opportunity to state my views on both current difficulties and broader questions of national transportation policy.

As the owners of Canadian Pacific, many of you must have been puzzled by certain conflicting statements that have appeared in recent weeks in the press -- and elsewhere -- regarding the future of your Company, and interpretations of our policies.

Perhaps the most remarkable feature of our results for 1973 is that the net income of CP Rail has fallen to about 25 per cent of our total net income. This is due principally, as the briefest examination of our financial statements would confirm, to gains resulting from increased world

prices for resource products of almost every kind, as well as from good results from Marathon Realty and CP Hotels, amongst our other investments.

But it is also the result of lowered earnings for CP Rail which faced a year in which traffic was very heavy, but in which the profitability of our operations was impeded by strikes and by the Minister of Transport's request for rate freezes.

I have seen in the press several times in recent weeks that Canadian Pacific might like to divest itself of its railway business. Let me say here and now that it has never been our intention -- and it is not our intention now -- that we should cease to participate in the railway business or, for that matter, in any other branch of transportation in which we are currently engaged.

It has been said recently in Parliament that there is something wrong with transport policy in Canada; that the National Transportation Act of 1967 is not working; that transportation should not be left to competing corporations whose actions are oriented by the profit motive. It has even been said -- by Mr. David Lewis --

that profit making is immoral when applied to national transportation policy "where transportation, just as much as energy, is the life-blood of the economy."

We have never been opposed to change; we are not opposed to it now, always provided that it is constructive change, resulting from calm and purposeful consideration, rather than from ill-informed hyperbole!

Those who consider that rail revenues should be reduced would do well to consider also which of the revenue uses they wish to see curtailed. First there is the revenue needed to pay adequate and satisfactory wage levels to our employees.

Then there are the funds needed to buy materials, to maintain our plant in workable condition, to meet the cost of accumulated debt and to meet CP Rail's annual share of our $157 million tax bill. Capital needs for CP Rail alone will be some $130 million in 1974. If any of these were reduced, within a few years the worst fears of our critics would be realized.

MORE

Then there is the profit -- yes, that is essential also. As Canadian industry expands, so will it become necessary to expand our plant and here I refer not only to CP Rail, but also to pipelines amongst other new infrastructure.

The Board would have to review very carefully any further increase in CP Rail's debt:equity ratio against the business risks involved and with due regard to business prospects more generally. CP Rail cannot live forever in a world in which new equity cannot be raised on a substantial scale and on terms that are both attractive to the investor and acceptable to the existing shareholder.

How ironic it is that those people who wish to see our revenues reduced are the very same people who complain the loudest when, in difficult conditions, our resources become over-extended. They perceive the problem, but they turn their backs on the only feasible solution.

This point was not lost on our forefathers. The original charter which formed the contract for the construction of CP Rail stipulated a 10 per cent per annum return on the investment that was originally made in the railway. The return in 1973 on CP Rail investment was a totally inadequate 4.5 per cent.

Today, the principle that business cannot remain healthy without adequate returns remains as valid as it was nearly a hundred years ago and it applies equally to nationalized corporations as to other companies. If, by some misguided application of sorcery, I should stand here today as head of some nationalized corporation, my speech would to this point be little different -- and no different at all where the need is concerned for funds to develop the growth of the transport capacity that is so essential to Canadian future prosperity. A buck is a buck whether it comes out of the pocket of a willing user or investor, or of an unwilling taxpayer.

The nationalization of our railway would not make transport cheaper to provide and it is irrelevant to the real life problems of transportation development in this country.

If the Government of Canada wishes transport operations to be conducted at prices reflecting less than full cost, then there is nothing to prevent them from paying subsidies to the users, but it should be recognized on all sides that this can only be accomplished by loading on the backs of the taxpayers the burden of making up the shortfall in revenue.

MORE

The prerogative of government is to govern and I shall limit my comments at this stage to pointing out what I believe would be the consequences on our business of uneconomic rates over the longer term.

The difficulty when, over some long period, rate levels are depressed below those commensurate with the full cost of the service provided, is that the use of transport is accelerated because it has become unduly cheap; but the flow of funds available to expand capacity grows smaller. As the economy expands, so the gap grows wider until ultimately the burden on the taxpayer becomes intolerable.

For anyone who doubts that this consequence is inevitable, the annual reports of the major European railways should be required reading. In Britain, for example, successive political solutions have failed to curb frightening deficits. Once the fundamental economic process by which the operation is geared to the needs of the community is disrupted, no political means can restore technical efficiency.

Through last fall, through the winter and up to the present time, demand for rail services has been booming. Canadian railways have often been unable to supply in peak periods

all the cars that shippers wanted. In common with other tight car supply situations we have lived through, this is a temporary phenomenon. It developed out of last summer's rail strike which disrupted railway operations for seven weeks, including a total shutdown of 10 days.

Just as we were beginning to catch up with the backlog of traffic, we were hit by one of the worst Prairie winters on record and we are continuing to suffer from the resultant floods. Canadian railroaders are not unused to coping with tough operating conditions, but this one hit us harder than most, because it was compounded by a very high level of traffic and a backlog remaining from the strike.

With the winter now behind us, CP Rail has accelerated grain shipments to meet the Wheat Board's targets. We are also making headway in meeting the needs of other shippers. But we shall continue to require the fullest co-operation of shippers -- not just of the Wheat Board -- and need it particularly to improve the turnaround times of freight cars.

MORE

It is not my purpose today, however, to gloss over the difficulties of Canada's transportation system because I am convinced that these will become more serious as years go by if their true causes are not diagnosed correctly and remedied soon.

Even if transportation ceased to be the most under-priced commodity in Canada, the buoyancy in our economy would lead to severe capacity problems within a few years. The capital expense involved in meeting this need will be no greater if raised by an investor-owned company such as ours, than if facilities were provided by organizations owned by the state. The likelihood is that we would achieve the work more economically.

The economics of the movement of grain continues to be a major and a very troublesome issue. This year, CP Rail's revenue from hauling grain is likely to fall short of the cost by more than $50 million. Each new wave of inflation brings new increases in our operating cost, but the freight rate for western grain remains unchanged.

MORE

The railways have been accused publicly of being unco-operative where expansion of their car fleets is concerned. Our Company has a long tradition of courtesy and co-operation in its relationship with the various levels of government. But we in Canadian Pacific cannot do the impossible; we cannot create funds to build new cars which are unable to bear even the cost of the labour and materials that are incurred.

Faced with this situation, we welcome the approach of the Federal Government to find a solution.

The future relationship between government -- at all levels -- and industry is a major issue and one which is likely to hold the political centre stage for many years to come. I propose to review this for the remaining minutes of this address. I shall do so partly because I do not believe that the relative role of government and of private enterprise in transportation can be debated logically other than in the context of the broader relationship of which it is part, but also because this is an issue that overhangs the future of all our business operations -- and, indeed, the future of Canadian business itself.

As I have already said, the prerogative of government is to govern, but the prerogative -- and the duty -- of managements is to point out, both to shareholders and to others, the probable consequence of the prospective courses of action that are contemplated.

Few would question the role of government in promoting projects of many kinds to achieve socially desirable objectives as well as to regulate the level of economic activity in the Keynesian manner. But the question of the balance between unproductive though socially desirable expenditures and commercially viable projects is a delicate one and one which has often eluded the skills of governments in other lands.

As the proportion of non-viable projects increases, so the load to be borne by the viable projects grows. As taxation rates -- both personal and corporate -- increase and as pressure for higher wages intensifies, one by one the previously viable industries cease to be self-supporting, to the point where rampant inflation and social unrest may take hold.

MORE

It is sometimes maintained that government -- whether federal or provincial -- is right to step in where Canadian business has failed to meet the challenge of opportunities in remote areas. I believe that it is timely to point out that every dollar removed from the Canadian capital market, because it has been taken by taxation from the pocket of the would-be investor, is a dollar that is denied to Canadian business. It is the government in the short term -- but the electors in the longer term -- who regulate the flow of funds by which the public and the private sectors activate their share of Canada's resources.

Furthermore, the starving of the capital market of investment funds, because it increases the yield necessary to attract funds to specific projects, restricts the range of business activity in the private sector. It is to stand the argument on its head to suggest that the government steps in where private enterprise has failed. It is much nearer the truth that it is the volume of expenditure of governments which limits the range of private business activity.

MORE

How strange it is that Canadians are often heard to complain that companies from south of the border and from elsewhere are taking over important Canadian business projects. Is it not true that these funds enter our country because the flow of funds available to Canadian business has been diverted by personal and corporate taxation into less profitable activities? What sense does it make that large amounts of Canadian money should be invested involuntarily at low rates of return whilst American money is invested in Canada at high rates of return? I believe that it is high time that all Canadians thought very seriously whether such policies are likely to engender the development of large and soundly based Canadian companies.

I have expanded my review this year for a variety of reasons. First and foremost, I wanted to set in reasonable perspective, a number of confusing issues which have confronted you as our shareholders.

Secondly, as the Chairman of one of the largest Canadian majority-owned companies, I felt it time that we set the record straight regarding the business climate in which we

operate and, at the same time, answered some of the accusations which have been leveled against us in recent weeks.

Thirdly, I thought it desirable that people generally should be made aware that the nationalization of this Company, or part of this Company, or -- for that matter -- of any other company is as irrelevant to transportation as it is to Canada's other problems.

Lastly, it seemed to me to be desirable that before setting off on any search for new legislation we should all of us pause for a moment and view the National Transportation Act of 1967 in the context of the overall relationship between the public and the private sector in managing our economy.

Many of you may feel, as I do, that the National Transportation Act provides a very sane balance between, on the one hand, the provision of adequate freedom for our vast transportation system to regulate itself by commercial means and, on the other hand, of the government to ensure the provision of adequate transportation in situations where competition is simply not feasible or where transportation

MORE

cannot be provided profitably. To regard such individual occurrences as the car supply problem of last winter as justification for new legislation is surely to treat the symptom but to ignore the nature of the disease.

In Canadian Pacific we see our role as transport contractors, and as suppliers of resource materials and of other services. We shall continue to fulfill these functions in any role that is appropriate to the changing business environment that awaits us or in any contractual relationship which makes good sense.

We offer in our staff, a collective expertise in transportation and resource industry management which is acknowledged the world over. But the common purpose, energy and enterprise with which these skills are applied and which distinguishes Canadian Pacific are rare flowers which blossom best in the climate of commercial discipline.

We ask only that we should be allowed to earn an adequate return on our investment not only because we owe this to you, our shareholders, but because of our deeply held conviction that, if this is denied, then strong and healthy

MORE

20

transport and resource industries are unlikely to flourish, whatever the status of their ownership.

The ultimate sin is to impose political expediency on problems of a technical and economic nature.

30